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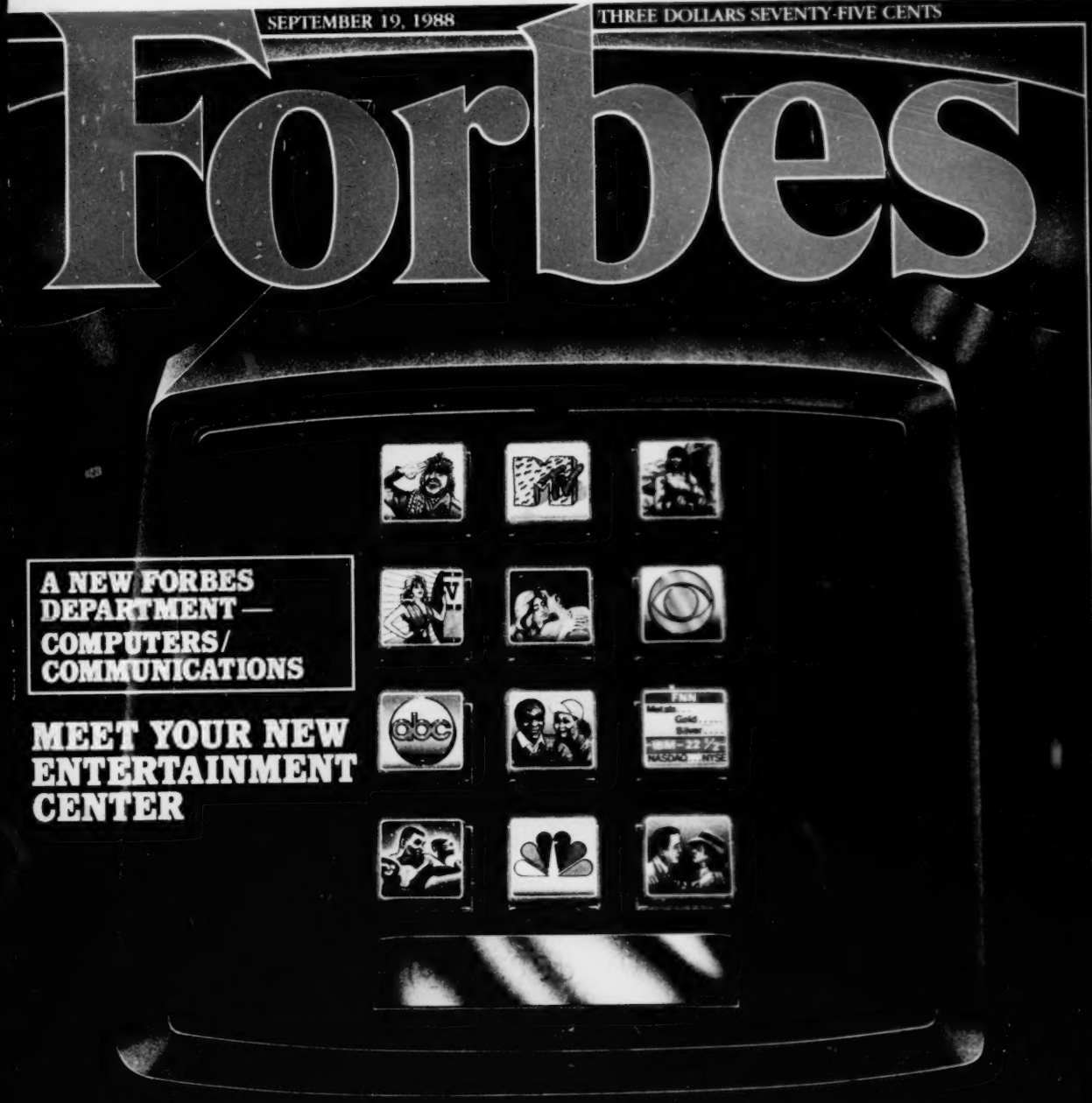

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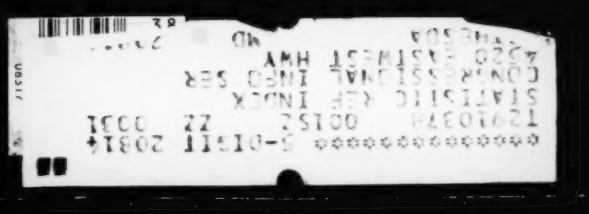

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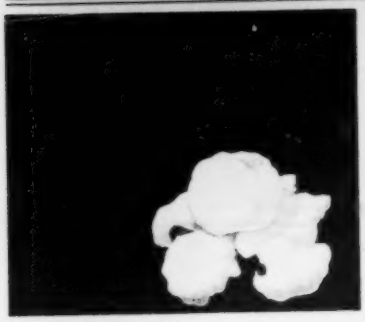

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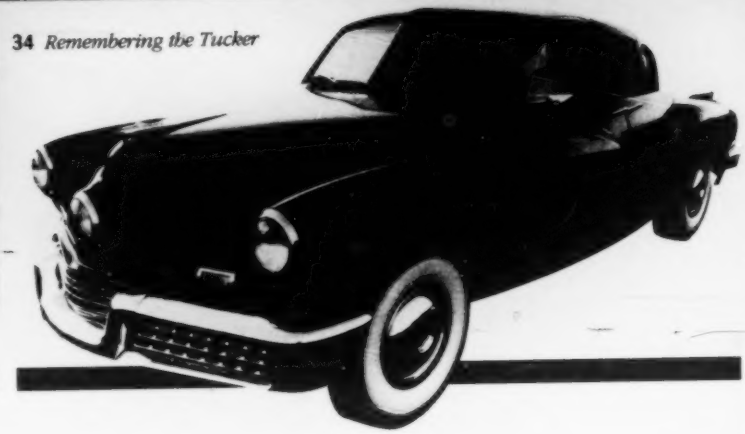

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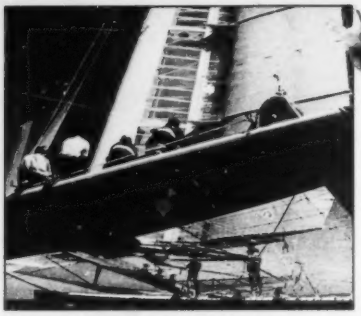

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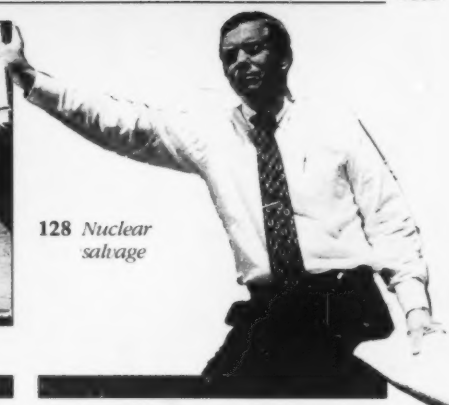

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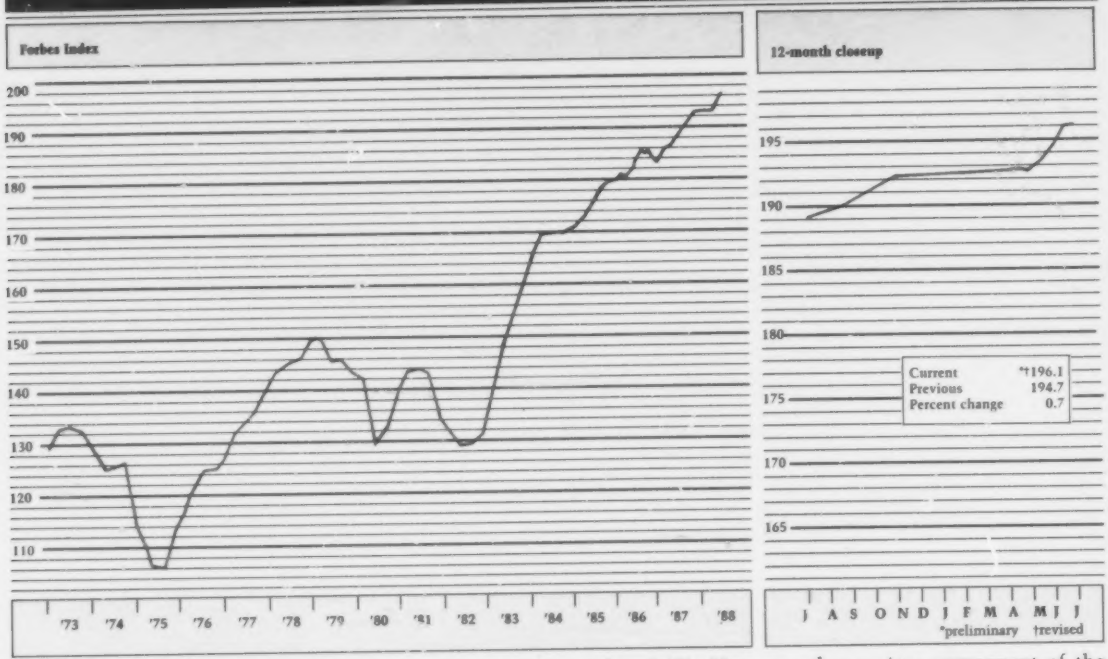
The Forbes Index



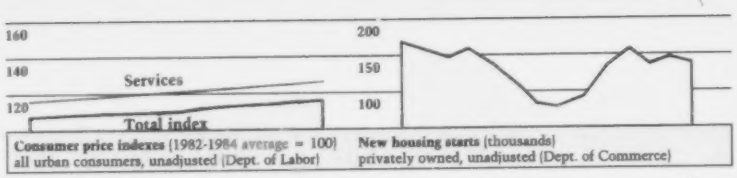
The heat is on. The revised second-quarter gross national product shows economic growth at a 3.3% annual rate, versus an earlier estimate of 3.1%. This is causing some concern that the economy may be expanding too rapidly. Industrial production jumped 0.8% in July as factory utilization, at 83.5%, hit an eight-year high. Personal income rose 1%, while the Consumer Price Index rose a modest 0.4%. However, the services component of the CPI was up 0.5%, and it is likely that the August figures for living costs will show even larger gains, attributable to rising food prices.

The one area that hasn't been particularly robust is new home construction. July new housing starts of 138,000 were off 7.2% from June and 9.4% from July 1987.

The Forbes Index Components

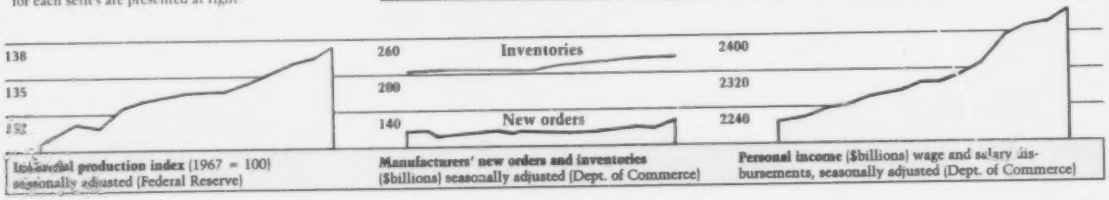
The Forbes Index is a measure of U.S. economic activity composed of eight equally weighted elements: Total industrial production, new claims for unemployment compensation, the cost of services relative to all consumer prices, the level of new orders for durable goods compared with manufacturers' inventories, total retail sales, new housing starts, personal income, total consumer installment credit.

To measure these eight elements, FORBES monitors ten series of U.S. government data. The last 14 months' data for each series are presented at right.



Consumer price indexes (1982-1984 average = 100) all urban consumers, unadjusted (Dept. of Labor)

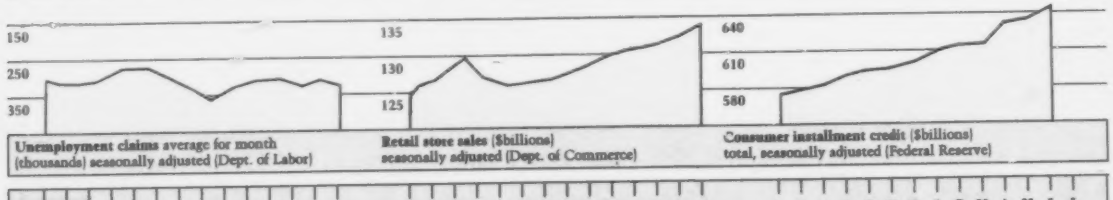
New housing starts (thousands) privately owned, unadjusted (Dept. of Commerce)



Industrial production index (1967 = 100) seasonally adjusted (Federal Reserve)

Manufacturers' new orders and inventories ($billions) seasonally adjusted (Dept. of Commerce)

Personal income ($billions) wage and salary disbursements, seasonally adjusted (Dept. of Commerce)



Unemployment claims average for month (thousands) seasonally adjusted (Dept. of Labor)

Retail store sales ($billions) seasonally adjusted (Dept. of Commerce)

Consumer installment credit ($billions) total, seasonally adjusted (Federal Reserve)

push insurance through Merrill's broker network. Both were remarkably successful, bringing in billions of dollars of premium income in their first two years of operations.

But Equitable—strapped for capital—couldn't put the newly sold insurance on its books. Last year alone Equitable, largely due to its capital scarcity, had to sell off $1.7 billion of insurance business to other insurers. In the end, then, Carter's sales efforts benefited other insurance companies. This summer Integrity Life was sold to an Australian outfit. Merrill Lynch has upped its stake in Tandem from 25% to 65%.

The bottom line: Equitable's capital shortage will likely condemn this once-venerable institution to at least two more years of stagnant asset growth—and perhaps even outright shrinkage.

With Walsh gone and Carter's power apparently eroded, can Dick Jenrette straighten out the mess? Jenrette is a sharp contrast to the typical Equitable chieftain of the past. With Dan Lufkin and William Donaldson, he founded in 1959 the brash young brokerage house of Donaldson, Lufkin & Jenrette. The young trio proceeded to shake Wall Street by bringing their firm public, becoming the first New York Stock Exchange member firm to do so. There is speculation that Jenrette may want to do something similar at Equitable. If he straightens the company out, Equitable could try a public stock offering *(see box)*.

Chairman Richard Jenrette came into Equitable in 1985 saying he didn't know much about insurance. But he crammed, and passed his underwriter's exam in record time. Can he move as fast to straighten out Equitable?

Jenrette came into Equitable as softly as a cat back in 1985. "I don't really know the insurance business," he told people. But in fact he had begun his career in 1951 selling insurance for New England Life. As soon as he arrived at Equitable, Jenrette studied up and quickly passed his insurance underwriter's examination.

Jenrette has been working to solve a longtime problem at the Equitable: the schism between the investment and sales sides of the business. Randall Proctor, a former Equitable executive in New York and agency head in Raleigh, N.C., has been hired as a consultant to explain the GIC problems and other financial complexities to the sales agency managers around the country. For generations this 11,000-person agency force has been the proving ground for Equitable's future executive talent. By hiring elder-statesman Proctor, the company seems to be acknowledging that bringing in the money is not enough. Managers also must learn how to put it profitably and safely to work.

While pleading innocent to being behind the boardroom coup, Jenrette concedes that he is taking a more activist role than previous chairmen of Equitable Life.

He has his hands full. ■

Thin cushions

Many mutual life insurance companies would love to go the way of Wall Street: issue stock to the public. How better to raise the capital they need to book more insurance and to build new businesses in stockbroking and mutual funds?

New York just last month passed legislation to allow mutuals to convert to stock companies, which would enable institutions such as Equitable, Mutual of New York and Metropolitan Life to make public stock offerings should they choose to do so. Demutualizing, as the process is known, has proved costly and cumbersome in the past. Nonetheless, eager investment bankers are drawing up proposals to split ownership between new stockholders and the mutuals' current owners—the policyholders.

Clearly, the mutuals need capital. Essentially, capital is a cushion against unexpected risk; and regulators are reluctant to let insurance companies without adequate capital take on new business. There aren't yet any hard and fast rules, but on average the industry's capital-to-assets ratio is 6.6%. Some big mutuals, by contrast, have 4% or less *(see table)*.

Many people blame the capital shortage on the ragtag army of state regulators who have permitted some mutuals to operate on thin capital margins. Unlike the U.S. banking industry, where federal regulators have pressed for higher capital margins, the states have had little success. Critics say state regulators are all too often under the thumb of insurance industry giants. Even state officials concede their inadequacies. Says Kenneth Merin, New Jersey insurance commissioner, "It is important to make sure companies do have adequate capital, and this needs to be done at the federal level."

—Gale Eisenstodt and E.A.F.

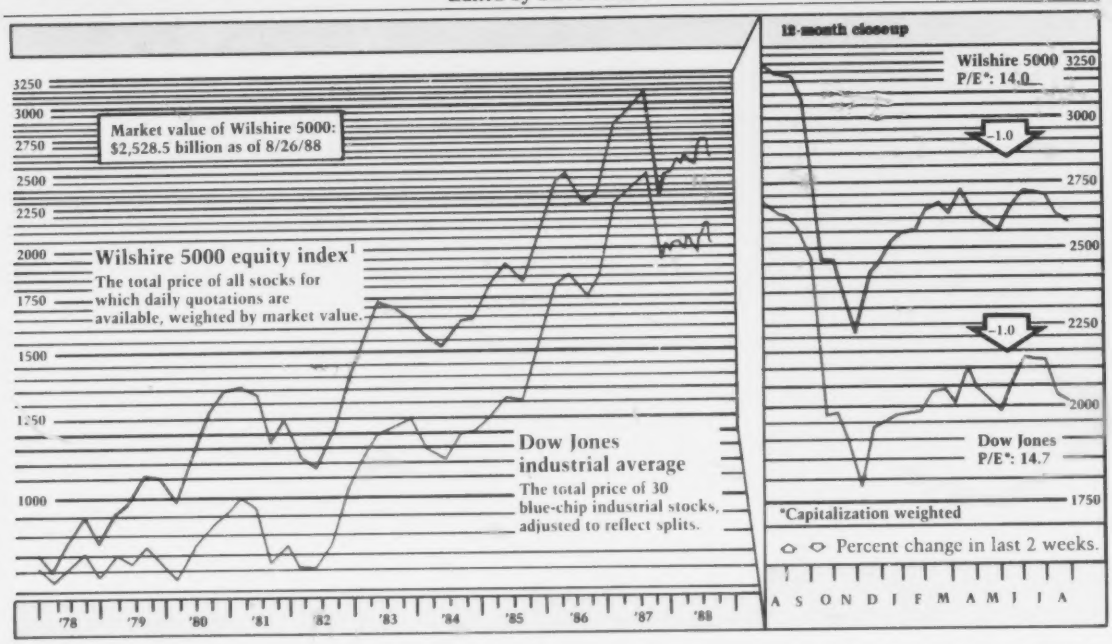
The top ten U.S. life insurers

Company	Assets	Capital & surplus	Capital ratio
Prudential Insurance	$108.8 bil	$3.47 bil	3.2%
Metropolitan Life	88.1	3.01	3.4
Equitable Life	49.3	1.25	2.5
Aetna Life	45.7	1.22	2.7
Teachers Insurance	33.2	1.38	4.2
New York Life	31.8	1.85	5.8
Travelers Insurance	28.6	0.96	3.4
John Hancock	27.4	1.01	3.7
Connecticut General	26.8	1.23	4.6
Northwestern Mutual	22.6	1.04	4.6

Source: A.M. Best Co.

The Forbes/Wilshire 5000 Review

Edited by Steve Kichen



Should you get out of the market? The recent low level of trading volume and the slow crumbling of share prices can't all be blamed on summer vacations. Volume on Aug. 26 of only 89 million shares was the lowest of the past 12 months, almost as low as the day after last Thanksgiving, which is traditionally one of the slowest trading days of the year. An eerie parallel has developed between today's market and that of the Depression market. After 1929's black Monday, and some feeble comeback attempts, prices drifted lower on weak trading volume. Monthly volume of 39.9 million shares in August 1930 was the lowest in three years. Then, in the last four months of 1930, the Dow took a 31.5% drubbing.

But you can find optimists. Laszlo Birinyi, a market analyst with Salomon Brothers, for example, expects people to get off the sidelines in due course. "Once the economic and political uncertainties become clearer," he says, "the market will move up to a new recovery high."

Closeup On the Equity Markets

Performance of six leading indexes

Percent change	Wilshire 5000	Forbes 500[2]	Dow Jones industrials	NYSE Composite	Amex Market Value Index	NASDAQ Composite
in last 4 weeks	–4.0	–4.1	–5.2	–4.0	–4.0	–3.3
in last 52 weeks	–19.5	–20.3	–23.6	–19.5	–18.3	–17.4

Stock performance based on six key investor yardsticks

Percent change	Company size		Volatility[3]		P/E multiple		Dividend yield		Growth profile[4]		Share price	
	large	small	high	low	over 23	under 9	over 4.7%	none	high	low	over $35	under $4
in last 4 weeks	–3.6	–0.7	–3.1	0.3	–3.3	–2.3	–0.7	–1.9	–1.9	–2.2	–3.5	–1.8
in last 52 weeks	–15.4	13.7	13.3	2.7	–11.1	–4.9	–1.4	16.1	12.0	–1.9	–11.5	8.3

[1]Wilshire index reflects price performance. It differs slightly from market value of outstanding stocks because of retirements of equity since index was created. [2]Based on sales. [3]A stock's sensitivity to overall market movement. High-volatility issues have wide price fluctuations, low-volatility issues are more stable. [4]A quantitative evaluation of a stock's growth image, determined by Wilshire Associates.

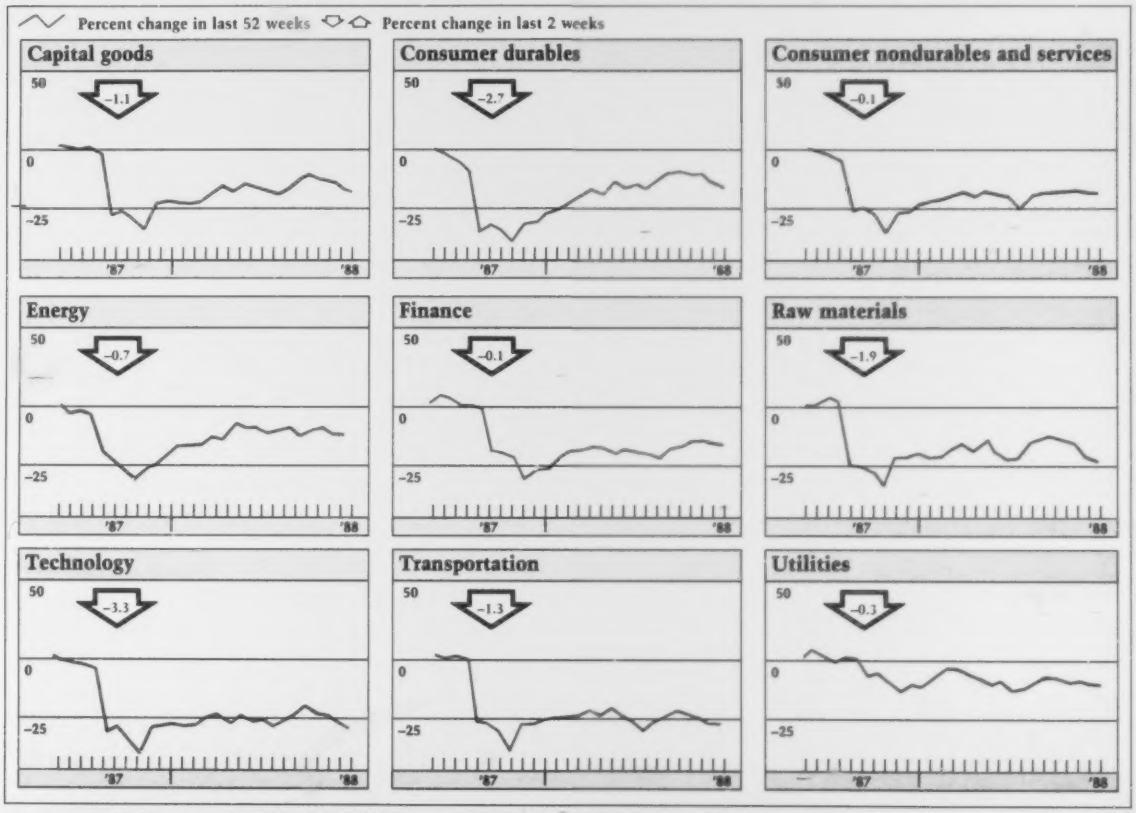
Steven Ramos

Note. All data for periods ending 8/26/88. Prepared by Wilshire Associates, Santa Monica, Calif.

Where the Action Is

Cheaper technology. The biggest casualty in the past two weeks was the technology sector, where a 3.3% loss leaves the group in the back of the doghouse. Bull market leaders such as Digital, Lotus and Seagate Technology are now at 52-week lows. IBM, trading at a modest 112, is only 21 above its 1973 high. In 1973 IBM earned $2.70 per share and traded at a hefty six times book; today the stock is less than two times book. Analyst John Jones of Montgomery Securities in San Francisco is looking for IBM to earn $9.87 this year and $11.85 next year. He rates the stock a buy.

The big winners? U.S. Shoe gained 40% on news of a possible sale or restructuring of the company. Also up was Wickes, up 54% for the same reason.



What the Analysts Think

The forecast for heavy industry improved in the last two weeks, as analysts raised their 1988 estimate for consumer durables. Lamson & Sessions, which makes thermoplastic pipe and automotive parts, saw its 1988 estimate rise over 19%. B.F. Goodrich, Champion Spark Plug and General Motors show slightly higher estimates.

Forecasting the Forbes Sales 500

Performance period	Average earnings per share	P/E
latest 12 months	$2.78	13.3
1988 estimates	3.59	10.3
1989 estimates	3.96	9.3

Rank based on change in estimate	Sector	Estimated 1988 EPS	Estimated 1988 P/E	% change in 1988 estimate in 2 weeks	% change in 1988 estimate in 4 weeks
1	Consumer durables	$4.65	11.3	1.06%	2.57%
2	Raw materials	3.18	9.4	0.85	2.89
3	Energy	3.09	12.0	0.69	1.33
4	Capital goods	2.65	14.0	0.01	0.51
5	Technology	2.92	11.1	-0.04	0.06
6	Utilities	2.40	9.7	-0.08	-0.15
7	Consumer nondurables	2.45	12.9	-0.23	-0.49
8	Transportation	2.34	10.8	-0.58	0.19
9	Finance	3.44	8.3	-0.99	-1.39

Earnings projections are capitalization-weighted consensus estimates from over 3,000 security analysts. Data are compiled and updated continually by the Institutional Brokers Estimate System (IBES), a service of Lynch, Jones & Ryan, a New York-based brokerage firm.

Note: All data for periods ending 8/26/88. Prepared by Wilshire Associates, Santa Monica, Calif., IBES, a service of Lynch, Jones & Ryan, New York.

Statistical Spotlight

The cash flow play in steel stocks is over. But there are other ways to profit from a resurging industry that was given up for dead almost two years ago.

Steel numbers

By Jack Willoughby

WHAT A COMEBACK: A little over a year ago Bethlehem Steel, the country's third-largest steel producer, was trading at 4⅝. Now it's at 20¾. And still it looks cheap, with cash flow per share for 1988 estimated at $10.50 by *Value Line*.

Chriss Street, a manager in the reorganized securities group of Bateman Eichler, Hill Richards in Los Angeles, has a word of advice for people about to buy steel stocks on the strength of their cash flow: Don't. There are some buys in this industry, he says, but they can't be spotted with a simple price-to-cash-flow ratio, and Bethlehem Steel isn't one of them.

In almost any other industry, a stock at two times cash flow would be takeover bait. If a stock is at two times cash flow, an acquirer could, in theory, buy the entire company and recoup its outlay in two years, assuming it reinvested nothing in plant and equipment.

But Bessie's strong recovery hides severe problems, says Street. They have to do with pension obligations. The company's unfunded liability—the amount by which its pension fund falls short of the money that should have been set aside from past payrolls—is a staggering $1.3 billion, or $17 a share. Put that back onto Bessie's balance sheet with the other liabilities, and the net worth (book value) of the company is wiped out.

A pension liability is more than a bookkeeping entry. It crimps the company's operations. Bethlehem might want to close old, inefficient plants, but it can't afford to. That's because past liabilities are eating up current profits. The liabilities only become larger if plants shut down, and with capacity down, those costs are loaded onto fewer tons of steel. Says Street: "People have assumed, incorrectly, that it's happy days again. But if demand falls back [further] to more realistic levels, liabilities like big unfunded pensions will stand pretty tall."

To be sure, the U.S. steel business has come a long way in the past five years. Steelworkers are more than a third more productive, producing a ton in five hours of work rather than eight. The capacity cutback, coupled with a declining dollar for most of the past three years that has made foreign steel more expensive, enables steelmakers to raise prices. In July cold rolled sheet went up as much as 5% at several producers, to $578 a ton.

This good fortune has landed with particular impact on the least efficient companies. Salomon Brothers says that Bethlehem's operating profit (profit before taxes and interest, and after depreciation) was about $63 a ton in the second quarter, up from $19 the same period last year. USX, which was in better shape to begin with, saw a less dramatic gain, from $31 to $70 a ton. Says Street: "In the early stages of a commodity rebound, the most inefficient producer gets the biggest bang." Thus investors must be careful not to project earnings-per-share growth into future years.

What will set successful steel companies apart will be their ability to upgrade and shift production as the boom starts to slow. Bethlehem will be hamstrung by its pension drag. So will Armco. But two strong companies without unfunded pension liabilities have the financial elbowroom to modernize and/or change their product mix: Inland Steel and USX. They're both trading at three times cash flow, more than Bethlehem. But they're both cheaper than Bethlehem and Armco in relation to book value, at least if book value is adjusted downward for the pension debt.

Street, whose specialty at Bateman is poring over bankruptcy court filings in search of special situations, has another buy recommendation: bonds of bankrupt LTV. "The LTV that will emerge is drastically different from the one that was put into bankruptcy in July 1986. But the bonds are still trading for those 1986 prices," he says. The Chapter 11 filing enabled the company to dump 35% of its capacity and 50% of its workers. After some haggling with the federal agency that insures pensions, LTV may be able to walk away from 25% of its $2.9 billion unfunded liability. The price of this reorganization will be a sharp haircut for the stockholders. Bondholders, Street says, will wind up owning most of the equity in the company. Street recommends the LTV Corp. 5s of 1988, recently trading at 31, and Republic Steel's 8.9s of 1995 at 31¼. ■

The good and the ugly

In judging a steel company, look beyond cash flow to pension debts. USX and Inland are overfunded, Armco and Bethlehem badly behind.

Company		Cash flow[1]	Pension surplus or liability	Book value[2]	Pension contribution[1]	Recent price
Inland	Buy	$10.50	$9.35[3]	$36	$0	35⅝
USX	Buy	8.00	3.09[3]	18	0	27¼
Armco	Sell	2.60	–4.54	8	0.82	9⅞
Bethlehem Steel[4]	Sell	10.50	–17.00	15	2.29	20¾

All data per share. [1]1988 estimate; net income plus depreciation. [2]Dec. 31, 1987. [3]Estimated Dec. 31, 1988 pension surplus, including excess pension fund earnings for 1988. [4]Reflects May share offering.

Sources: Bateman Eichler, Hill Richards Inc.; Value Line.

The Forbes/TUCS Institutional Portfolio Report

Edited by Steve Kichen

MARKET TIMERS are back, but they aren't doing terribly well, at least for institutional investors.

Timing—switching between stocks and either cash or bonds—was a popular theme in the 1970s. The idea was to participate in bull markets while deftly sidestepping bear markets by switching out at the right moment. After falling into disrepute for a while the strategy has enjoyed a resurgence. Renamed "asset allocation," it has a strong following again among pension sponsors. For the retail trade there are a dozen or so mutual funds that aim to asset-allocate their way around market crashes.

The mutual funds are for the most part too new to judge, but data are in on the pension managers. They come to us from the Trust Universe Comparison Service, managed by Santa Monica, Calif.-based Wilshire Associates. TUCS monitors 4,500 pension accounts, which hold 20% of the country's $2 trillion in corporate and government pension assets.

TUCS finds that, over the past two years, the average market timer delivered a 6.5%-per-year return. That isn't terrible, but it lags behind three of the five other strategies TUCS follows *(see table at lower left)*. This period, however, should have been an ideal environment for a timer, what with a powerful bull market followed by a big crash. Someone who caught the up move and then switched out before the crash would have soundly beaten any of the buy-and-hold strategies.

If we include all six strategies, the average institutional equity manager performed in line with the market in the most recent quarter, with a 6.4% total return (dividends plus capital gains or losses). The Wilshire index of 6,010 stocks posted a similar return of 6.6%.

Common stocks had the best returns during the quarter and strongly outperformed both fixed income and cash. But this only helped to close the 12-month gap created by last October's debacle. Over the last 52 weeks fixed-income accounts enjoyed a median total return of 7.6%, while equity investments are off 5.9%.

Pension managers have been adding slightly to their equity holdings while pulling out of fixed income *(see "Segment performance" at right)*. But James D. Awad of BMI Capital says he's not looking to pension funds to prop up the equity market. "Foreigners, public funds, individuals and corporations—any one of these alone will trigger the next up move," he says.

How different managers performed

Manager style	Total return[3] recent quarter	12 months	24 months[4]
Diversified	5.7%	–4.8%	7.8%
Growth	5.8	–6.9	5.9
Growth—emerging	7.0	–2.6	5.6
Market timer	5.1	–2.7	6.5
Sector rotator	5.6	–5.2	6.6
Value	6.7	–3.0	8.7

Where the institutions put their money

Segment	—Portfolio weighting— most recent quarter	previous quarter
Equity	60.1%	57.2%
Fixed income	28.9	30.9
Cash and equivalents	10.4	10.8
Convertibles	0.1	0.7
Other[1]	0.5	0.4

Equity portfolio characteristics

	Institutional portfolios	Wilshire 5000
Price/earnings ratio	15.1	14.9
Dividend yield	3.2%	3.3%
Beta[2]	1.05	1.06
Price/sales ratio	1.33	1.40
Price/book ratio	2.87	2.30

Segment performance and cash flows

Segment	—Most recent quarter— median total return	shift in institutional holdings	—Latest 12 months— median total return	shift in institutional holdings
Equity	6.4%	0.6%	–5.9%	–2.0%
Fixed income	1.1	–2.8	7.6	–7.4
Cash equiv	1.7	–4.5	7.2	–15.3
Convertibles	4.6	–6.7	–0.5	–1.1
Other[1]	1.6	0.0	6.4	–5.2
Total	4.7	–0.8	1.8	–4.7

Position changes: These securities had the greatest relative change in holdings over the last quarter

Security	Increase in holdings	Total quarter return	Security	Decrease in holdings	Total quarter return
General Motors	2.6%	14.2%	Amoco	–2.7%	–0.3%
Ford Motor	2.2	25.8	Baxter Intl	–2.3	–10.9
Federal Nat Mtg	2.1	36.1	American Brands	–1.9	11.0
Alcoa	1.8	23.2	BellSouth	–1.8	12.7
Digital Equip	1.7	9.9	Am Home Prods	–1.8	–2.6
Cincinnati Bell	1.6	26.7	Bell Atlantic	–1.5	10.2
Cigna	1.5	1.9	Pfizer	–1.4	–5.4
Warner Comm	1.5	19.8	AT&T	–1.4	0.2
First Chicago	1.5	33.9	SmithKline	–1.2	–15.5
Syntex	1.4	23.0	Philip Morris	–1.2	–5.4

[1]Real estate, foreign investments, venture capital, guaranteed insurance contracts. [2]A measure of risk. A stock with a beta of 1.00 tends to move up or down at the same rate as the S&P 500. [3]Includes all forms of investments. [4]Figures for 24 months are annualized.

Note: Data for quarter ending 6/30/88. Prepared by the Trust Universe Comparison Service (TUCS®), a service of Wilshire Associates, Santa Monica, Calif.

Where the institutions are—and aren't

Most overweighted relative to Wilshire 5000			Most underweighted relative to Wilshire 5000		
	% of			% of	
Security	institutional universe	Wilshire 5000	Security	institutional universe	Wilshire 5000
Ford Motor	1.2%	0.8%	Exxon	1.3%	3.0%
Apple Computer	0.5	0.2	Matsushita Elec ADR	0.0*	1.3
Intel	0.5	0.1	Hitachi Ltd ADR	0.0*	1.1
Caterpillar	0.6	0.2	British Petroleum ADR	0.1	1.2
Alcoa	0.5	0.2	IBM	3.3	4.3
Warner Communications	0.5	0.2	AT&T	0.7	1.6
Philip Morris	1.3	1.0	General Electric	1.5	2.3
Digital Equipment	1.0	0.8	Royal Dutch Petroleum	0.8	1.5
Computer Associates	0.2	0.0*	Glaxo Holdings ADR	0.0*	0.7
Unocal	0.4	0.2	BellSouth	0.5	1.1

Ford is number one with the institutions. With a 50% overweighting relative to its market capitalization in the Wilshire index, Ford tops the list of institutional darlings. Ford has surpassed GM in profits the last two years and raised its dividend four times during this span.

Of the nine Wilshire sectors, raw materials lost the most weighting in the institutional portfolio in the June quarter. That sector, which includes Dow and Du Pont, has exhibited strong earnings momentum. But institutions are looking ahead to the next recession.

Sector activity and top holdings

% of institutional portfolio: ■ most recent quarter ■ previous quarter

Capital goods	5.4% 6.2%	Consumer durables	4.8% 4.3%	Consumer nondurables	28.4% 28.9%
	total return		total return		total return
General Electric	9.6%	Ford Motor	25.8%	Philip Morris	–5.4%
Caterpillar	8.9	General Motors	14.1	Merck	8.1
Westinghouse Electric	9.7	Chrysler	4.9	Wal-Mart Stores	9.0
Emerson Electric	7.5	Goodyear Tire & Rubber	2.2	Coca-Cola	6.6
Cooper Industries	0.8	Matsushita Elec ADR	–12.3	Squibb	–1.4
Energy	**9.3%** 8.8%	**Finance**	**12.3%** 11.7%	**Raw materials**	**14.1%** 15.2%
	total return		total return		total return
Exxon	9.4%	American Express	13.7%	Dow Chemical	12.3%
Amoco	0.3	American Intl Group	8.8	El du Pont de Nemours	16.2
Atlantic Richfield	–4.2	JP Morgan	18.1	Waste Management	2.1
Royal Dutch Petroleum	–4.5	Citicorp	32.4	Monsanto	9.2
Mobil	–0.4	Aetna Life & Cas	4.5	Alcoa	23.2
Technology	**16.5%** 15.1%	**Transportation**	**4.4%** 4.1%	**Utilities**	**4.8%** 5.7%
	total return		total return		total return
IBM	19.5%	Union Pacific	2.5%	AT&T	0.2%
Digital Equipment	9.9	CSX	–10.1	Nynex	5.2
Hewlett-Packard	–8.1	Norfolk Southern	8.1	BellSouth	12.7
Apple Computer	15.8	Ryder Systems	–2.1	Southwestern Bell	11.2
Boeing	27.4	Burlington Northern	3.8	Pacific Telesis	6.0

*Exact figure is less than 0.05%.